

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of:	
High-Cost Universal Service Support	WC Docket No. 05-337
Federal-State Joint Board on Universal Service	CC Docket No. 96-45

**COMMENTS OF THE RURAL IOWA INDEPENDENT
TELEPHONE ASSOCIATION**

On January 9, 2008, the Commission adopted an order seeking comment on reverse auctions as a form of competitive bidding, to determine the amount of high-cost universal service support provided to eligible telecommunications carriers (ETCs) serving rural insular and high cost areas. The Commission proposes that in a given area, support would be determined by the lowest bid to serve the auctioned area. Notice of Proposed Rulemaking (NPRM) ¶ 1. The Commission cites to several proposals made by wireless carriers.

The Rural Iowa Independent Telephone Association (RIITA) opposes all reverse auction proposals because the reverse auction concept jeopardizes actual service and service quality in high-cost rural areas. Other proposals made in other orders, specifically the Commission's proposal to eliminate the identical support rule, will be more effective in reforming the Universal Service Fund (USF) than the reverse auction proposal. Because the reverse auction proposal will encourage companies to bid less than the amount required to provide quality service to rural areas and will encourage companies to bid that

do not serve entire communities, the proposal will result in lower quality service to areas that need high-quality telecommunications systems to support present and future broadband demands. Further, the proposal will result in loss of service where new competitors underbid and then fail, leaving areas without telecommunications services for the first time since the adoption of the Telecommunications Act of 1934. This also would violate the very purpose—and statutory directive—of universal service in the Telecommunications Act. RIITA will discuss problems with the proposal in more detail below. More significantly, RIITA opposes this proposal entirely and asks that the Commission not adopt any reverse auction proposals. RIITA notes that it has provided comments in this docket opposing reverse auctions in the past.

RIITA is a non-profit association of rural independent telephone companies, representing approximately one hundred and thirty Iowa incumbent local exchange carriers. RIITA's membership is restricted to mutual telephone companies in which at least fifty percent of the users are owners, co-operative telephone corporations or associations, and telephone companies having less than fifteen thousand customers and less than fifteen thousand access lines that serve rural Iowa and are incumbent local exchange carriers (ILECs) as defined in the 1996 Telecommunications Act. Approximately one-half of our member companies serve communities with fewer than 1000 access lines. All RIITA members are ILECs and all RIITA members are Eligible Telecommunications Carriers (ETCs). Only an extremely small percentage of those communities have wireline local exchange competitors; many have wireless carriers serving portions of their communities that are also ETCs.

Community-based rural service providers have historically used Universal Service Fund distributions for their intended purpose: the provision of rural telecommunications service. In Iowa, RIITA members have directly invested those funds into high-quality technology and service, providing those services throughout their communities regardless of whether their customers are in rural areas or in town. The communities served by RIITA members were not served by the Bell System and would not likely be served throughout their exchanges by other carriers if the members were to terminate service.

Our member companies' commitment to service has resulted in substantial investment in the equipment and plant necessary to provide this service. These long-term investments create a regulatory contract with substantial investment-backed expectations of returns. Even those returns have not been high: the vast majority of Iowa's rural carriers are average schedule companies that see returns on their investments below the rate of return allowed by the Commission and substantially below the returns of large urban carriers. Our member companies invested in and built the networks that are in place in their exchanges:

The facilities of the regulated network industries did not fall like manna from heaven, but rather were established by incumbent utilities through the expenditures of their investors. Utilities made past expenditures to perform obligations to serve in expectation of the reasonable opportunity to recover the costs of investment plus a competitive rate of return.

J. Sidak & D. Spulber, *Deregulatory Takings and the Regulatory Contract* 538 (1998).

Many of these exchanges have seen an increase in indirect competition. Wireless carriers provide voice service in select portions of the exchanges; some towns have cable providers that also offer voice and high-speed data services. Satellite video services are

available in many areas. Other than the community-based providers, generally RIITA's members, no land-based video service exists in rural areas. The same applies to rural broadband service. In rural communities served by community-based carriers, residents have had access to state of the art broadband services for many years—longer than most residents in most Iowa cities. The partial competition gives an impression of competition that is not a complete picture. The Commission's own competition studies have shown a decline in competition in telecommunications services since 2004.¹

As the Commission adopts regulations intended to move toward competitive markets, a certain amount of caution is justified. Mistakes in implementing partial market solutions can lead to less-efficient markets than the traditional markets: "Partial adoption may be politically expedient, but a course that undertakes to institute only a subset of the requirements prescribed by the competitive-market model for regulation cannot be expected to improve matters, much less to constitute a maximal contribution to the public welfare." W. Baumol and J Sidak, *Toward Competition in Local Telephony* 140-141 (1994). As Baumol and Sidak explain in detail, the test of good regulatory policy ought to be the public welfare.

Auctioning fund distribution threatens the public welfare. Fund auctions create a number of practical problems, which are not generally addressed in the NPRM. For example, auction design must address:

- How to avoid rewarding carriers that would submit low bids by providing lower quality services.

¹CLECs have been reporting a decline in access lines annually since 2004. Trends in Telephone Service (Federal Communications Commission Industry Analysis and Technology Division; February 2007) Chart 8.2 at p. 60, available at <http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270407A1.pdf>.

- How to provide continued incentive to invest and modernize networks after a bid has been won.
- How to deal with different technologies that may satisfy needs of some parts of communities better than others. For example, cellular service may be an adequate substitute for wireline service for some households in a community, but not others. Must a bidding carrier address the requirements for every household in a serving territory? If not, how many would be enough to qualify a bid?
- Bidders would have asymmetric information: the ILEC's costs are public knowledge, but other potential bidders' costs are not. This makes it hard to design an auction that would reveal the true costs for these other bidders.
- Would competition be permitted after an auction?

Lehman, "Ten Myths That Could Destroy Universal Service," at 15, Dr. Lehman further noted, "the use of simple auctions may deliver the wrong market structure or the wrong subsidy level in simple environments," quoting Laffont and Tirole, "Competition in Telecommunications," the MIT Press at 260 (2000). Dr. Lehman concludes, "Auctions are not ready for prime time." Lehman at 16.

The risk is serious: "Based on an analysis of 2006 HCP data, it is estimated that approximately 2.7 million rural households (or about 7.1 million Americans) would be at risk of losing access to affordable telephone service in the absence of HCP support to carriers serving rural areas." Keybridge Research LLC, "Consumers at Risk: The Impact of Reduced Universal Service Fund Support on Telephone Service Affordability in Rural America" at p. 18, available at:

[http://76.12.79.232/webmasterpro/published/news/USF.Study.Final.V5.\(09.30.06\).pdf](http://76.12.79.232/webmasterpro/published/news/USF.Study.Final.V5.(09.30.06).pdf)

In a study performed by Dr. Dale Lehman and attached to earlier comments of the National Telecommunications Cooperative Association in this docket, Dr. Lehman reviews successful and unsuccessful auctions, concluding that in some instances, auctions can be

used to promote the public welfare in an efficient manner. However, he concludes that the successes would not apply to implementing reverse auctions in the U.S.:

Reverse auctions in the U.S. are a different matter. There are multiple existing infrastructures, utilizing different technologies, providing different services, and with different serving areas. Universal service is an evolving set of service requirements that is difficult to forecast. The performance of auctions in this setting is theoretically and empirically untested. The limited evidence suggests that these are difficult problems.

Lehman, "The Use of Reverse Auctions for Provision of Universal Service" at p. 22, available at:

http://www.ntca.org/content_documents/ReverseAuction.Lehman.pdf

Even these studies understate the risk to telecommunications in rural areas because much of the wireless traffic in these areas transits wireline networks that could be lost if the owners—rural community-based carriers—were to go out of business. See "Consumers at Risk" at p. 18 ("The wireline network infrastructure, which carries wireline, wireless and many IP voice calls, could itself be at risk due to the cascading effects of households potentially exiting the telephone network.")

Economic issues run even deeper than the practical concerns raised by Dr. Lehman and the Keybridge Research study. While working toward free-market competition, it is important not to create inadvertent misallocations of resources. Economic benefits of competition arise from the variety of services and innovations in the market, not from forcing short-term cost savings:

Achieving the benefits of market allocation, however, does not mean that regulators should transfer income from regulated utility investors to consumers. Regulators should not confuse such income transfers with efficiency gains. Instead, regulators should establish basic rules for an orderly transition to competition that rely on competitive innovation and cost cutting as the sources of consumer benefits.

Sidak and Spulber at 496.

An auction of distribution funds is designed solely to transfer income from investors to customers and risks denying companies return on their investment. Ultimately, that will lead to less investment in rural communities and lower service.

If companies have an incentive to bid down Universal Service, low bidders may fail to deliver service. By then, the former ILEC rural provider may have lost the ability to provide adequate service either by leaving the market or by not having the capital necessary to continue to invest. Consumers lose if that happens. This issue was illustrated in the Commission's original order seeking comment on reverse auctions. That order would have required a bidder to have a network capable of serving 90% of households, *though that could be phased in*. An attachment would have required the service of remaining households by purchase and resale, *whenever possible*. In rural areas served by an ILEC providing 100% service, with purported competitors providing partial area service, like wireless or cable, this auction creates the potential for less customer service and lower quality service.

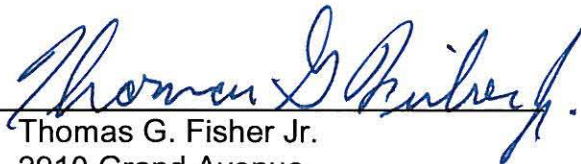
Fund issues should be fixed by addressing the underlying problems of awarding distributions to companies that do not provide universal service, rather than by economically disabling the companies that already provide universal service and have a history of providing universal service.

The goal of universal service is to provide service to all customers across the United States. That goal will not be served by auction proposals.

The conclusion of these studies is simple: reverse auctions put rural telecommunications customers at risk. This proposal does not serve the public welfare and would violate the Telecommunications Act by denying service to communities that are entitled to telecommunications services at reasonable rates as provided for in the Act.

RIITA opposes the rural auction proposals discussed in the NPRM.

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